

QUALIFIED SICK PAY PLAN GUIDE



CUSTOMIZED
FINANCIAL
SOLUTIONS —
PERSON
BY PERSON.™

ODDS ARE IT'S GOING TO HAPPEN. BE READY.

What would you do if one of your key employees were disabled for a period of time? Are you prepared for the serious problems you may face should a key employee suffer a serious illness or accident? An insured Qualified Sick Pay Plan can help you answer these questions.



FEATURES AND BENEFITS.

TAKE A LOOK AT THE ADVANTAGES A QUALIFIED SICK PAY PLAN HAS TO OFFER:

- Both you and the employee are aware of the length and amount of benefits a non-productive, disabled employee would receive, eliminating a potential precedent-setting situation.
- The amount of your financial obligation has been established prior to the onset of an employee's disability.
- Disability criteria and qualifications for receiving benefits are clearly defined. A third party, the insurance company, determines the extent of the disability, thus removing the burden from you.
- Any benefits paid to a disabled stockholder employee will be considered wages by the IRS (not as a dividend).
- Premiums are paid when all employees are actively at work providing potential earning power.
- Benefits are paid when a key employee is disabled and the potential earning power is low.
- Premium payments can be deductible as ordinary and necessary business expenses by the employer.

Not only does a Qualified Sick Pay Plan offer you the solution to a potentially costly problem, it benefits your employees, too.

WITH AN INSURED QUALIFIED SICK PAY PLAN:

- Employees are protected against loss of income due to disability.
- Only benefits paid during the first six months of disability are subject to Social Security taxation.
- Financial obligations to the Plan remain constant, regardless of the amount of disability benefits that are paid.



“Pat and I began our architectural design firm about 10 years ago. With a lot of hard work, we’ve established our business among the premiere design firms in the country. A key to our success has been the ability to foster and maintain relationships with clients. A comprehensive benefits package that includes a Qualified Sick Pay Plan has proven to be an asset in the retention of our most valuable employees. It gives us the competitive edge in client relationships. And, in our business, that’s what it’s all about.”

*Patrick O. and Ian P.
Co-owners of an architectural design firm*

CONSIDER THE FACTS AND THE OPTIONS.

T*he risk of total disability is greater than the risk of death between ages 20 and 65.*

Chances that a 90-day disability will occur before age 65

Age	...in a group of 2 people	...in a group of 3 people	...in a group of 4 people
30	55.2%	70.0%	79.9%
40	49.7%	64.3%	74.4%
50	40.1%	53.7%	64.2%

Source: 1985 Commissioners' Disability Table

YOU HAVE OPTIONS IN FUNDING A PLAN.

Establishing a Qualified Sick Pay Plan relieves your tax problem, but addressing the funding and administration are also critical issues. Should you retain all the financial risk of having to pay disability benefits out of your firm's assets, or should you transfer most of that risk to an insurance company? Most business owners choose to transfer all or some of the liability for plan funding. The information illustrated in the following chart may help you in making your decision.

Consider...	If you (your firm) retain the entire risk...	If you transfer most of the risk to an insurance company...
FAS 112 requirements	You must meet reserving requirements for claims and carry as a liability on your balance sheet.	The insurance company assumes the risk for claims according to the terms of the contract.
Who determines when there is a claim?	You must determine whether there is a claim.	The insurance company must determine whether there is a claim.
When should the last payment be made?	You decide if and when the person has recovered.	The insurance company, with experienced disability professionals, decides if and when the person has recovered.
Can you control the cost and timing?	Large benefit checks need to be paid out by you at the worst possible time—when you're already missing a key employee.	Smaller and pre-determined premium payments need to be made by you at the best possible time—when everyone is healthy and working. And you can deduct these from your income tax as a necessary business expense.**
Who has the liability?	You have full liability.	The insurance company accepts the liability.

**Premium payments made by an employer on behalf of employees are tax-deductible. (IRC Sec. 106). Premiums paid on behalf of partners, sole proprietors and S corporations 2%-shareholders are not tax-deductible. There is, however, no limit on the amount of disability benefits that can be received tax free by these special classes of business owners. (IRC Sec. 104 [a] [3]).

COURT CASES.

CHISM:

The Chism Ice Cream Company paid what it claimed was sick pay to a disabled employee for some five years before he died. The Tax Court found that there was no plan and noted the absence of anything detailed in writing. The Tax Court decided the payments were not “sick pay” and the employee exclusion for disability payments was disallowed. As a result, the estate had to pay a substantial amount of taxes due. In addition, the Company was not allowed the deduction of payments to the executive. The payments were, in the eyes of the Court, classed as informal dividends [Est. of E.W. Chism, TC Memo 1962-6, aff’d 322 F.2d 956 (9th Cir. 1963)].

CHESAPEAKE:

The Chesapeake Manufacturing Company, Inc. could be cited as authority for the proposition that an employer may lose the deduction for payments made to a disabled employee if there is no evidence to show that these payments were, in fact, made on account of an employee’s disability. In this case, there had been a history of shareholder/employee withdrawals that were carried on the books of the corporation as employee advances. One of the shareholders became disabled. During this period of disability, the company took a deduction for these advances as disability payments. However, the Court felt that these amounts could not be considered sick pay, but were mere nondeductible “informal dividends.” It took this position for three reasons: (1) the corporation itself did not earmark the amounts paid as disability payments; (2) there had been little, if any, corporate history of disability payments to any other employees; and (3) there was no evidence to show that the corporation had ever established or considered establishing any type of disability payment arrangement. The Tax Court stated that the payments were not made because of disability and hence not deductible (Chesapeake Mfg. Co., Inc., v. Comm., TC Memo 1964-214).

These are only court case examples and are not to be construed as legal advice. It is important to seek the advice of an attorney, as state laws vary considerably.

Here are examples of actual court cases involving businesses that failed to implement proper “sick pay” plans.

DISABILITY INSURANCE AND FEDERAL TAXES.

Meet with your financial advisor and discuss the benefits of a Qualified Sick Pay Plan.

Disability Income and Federal Taxes

Organization Form	Coverage for	Premium Paid by	Owner/Beneficiary	Tax Treatment	
				Premium	Benefits
Individual	Individual	Individual	Individual	Not deductible (IRC Sec. 213) and (IRC Sec. 262)	Tax free [IRC Sec. 104(a)(3)]
Sole Proprietorship*	Sole Proprietor	Sole Proprietor	Sole Proprietor	Not deductible business expense (IRC Sec. 213) and (IRC Sec. 262)	Tax free [IRC Sec. 104(a)(3)]
	Employee	Employer	Employee	Deductible business expense Not taxable income to employee (IRC Sec. 162) and (IRC Sec. 106)	Benefits reported as income (IRC Sec. 105)
	Employee	Employer	Employer	Not deductible business expense (IRC Sec. 265)	Tax free to sole proprietor [IRC Sec. 104(a)(3)]
Partnership	Partner	Partnership	Partner	Not deductible business expense (IRC Sec. 262) and (IRC Sec. 162)	Tax free [IRC Sec. 104(a)(3)]
	Employee	Employer	Employee	Deductible business expense Not taxable income to employee (IRC Sec. 162) and (IRC Sec. 106)	Benefits reported as income (IRC Sec. 105)
	Employee	Employer	Partnership	Not deductible business expense (IRC Sec. 265)	Tax free to partnership [IRC Sec. 104(a)(3)]
C.Corp	Employee	Corporation	Employee	Deductible business expense Not taxable income to employee (IRC Sec. 162) and (IRC Sec. 106)	Reported as income (IRC Sec. 105)
	Employee	Corporation	Corporation	Not deductible business expense (IRC Sec. 265)	Tax free to corporation [IRC Sec. 104(a)(3)]
	Employee	Employee funds received through executive bonus	Employee	Executive bonus is tax deductible to the business and is reported as income to the employee	Tax free [IRC Sec. 104(a)(3)]
S.Corp	More than 2% Shareholder	Employer	More than 2% Shareholder	Entity deductible expense (IRC Sec. 162) individual income taxable (IRC Sec. 61)	Tax free [IRC Sec. 104(a)(3)]
	Employee or 2% or less Shareholder	Employer	Employee	Entity deductible expense	Benefits reported as income (IRC Sec. 105)
	Employee or 2% or less Shareholder	Employee funds received through executive bonus	Employee	Executive bonus is tax deductible to the business and is reported as income to the employee	Tax free [IRC Sec. 104(a)(3)]

Disability Overhead Expense

Organization Form	Premium Paid by	Owner/Beneficiary	Premium	Tax Treatment Benefit
All Forms of Eligible Business	Sole proprietor or business	Sole proprietor or business	Tax deductible (Rev. Rule 55-264, 1955-1 CB 11)	Reportable as income. However, overhead expenses which are deductible as ordinary business expenses will, to the extent deductible, offset the reportable benefits.

These illustrations should not be considered legal advice. The facts of a particular situation may change the results indicated by these general illustrations.

EMPLOYER PAID VERSUS EMPLOYEE PAID.

As an employer, should I pay the premiums for a Qualified Sick Pay Plan, or should my employees pay the premiums under a Section 162 Bonus Agreement?

Assumptions: 35 Year-Old Non-tobacco User	
Earned Income	\$ 105,000
Exemptions/Deductions	-25,000
Taxable Income	\$ 80,000
Taxes Due	\$ 17,187

Insured		
Employee Paid Section 162 (Tax Free Benefits)		Employer Paid Section 105 (Taxable Benefits)
\$ 4,750	Monthly DI Benefit*	\$ 6,000
\$ 57,000	Annual DI Benefit	\$ 72,000
N/A	Exemptions/Deductions	\$ 25,000
N/A	Taxable Income	\$ 47,000
N/A	Tax Due	\$ 7,947
\$ 57,000	Disposable Income	\$ 64,053

Corporation		
Section 162		Section 105
\$ 1,746	Premium	\$ 2,173
\$ 1,746	Bonus	0
\$ 679	Double Bonus	0
\$ 2,425	Gross Corporate Outlay**	\$ 2,173
\$ 1,600	Net Corporate Outlay	\$ 1,434

* Maximum available based on our current Issue and Participation limits.

**We assume corporation to be in 34% tax bracket



“My wife Arlene and I are managers of a family-owned and operated business. We were very uncomfortable with the idea of having to determine the extent of a disability should a key employee suffer a debilitating injury or illness. That’s one of the reasons we added a Qualified Sick Pay Plan to our benefits package. Now that burden is no longer ours, but lies with the insurance company. We feel good that we’ve provided an added benefit for some very important people in our lives.”

*Bill and Arlene R.
Managers and co-owners
Floral shop*

SAMPLE:

QUALIFIED SICK PAY PLAN AGREEMENT.

(Name of Company) recognizes that the risk of being sick or hurt is far greater than the risk of dying during employment years, and therefore provides its employees with the following disability income benefits:

TOTAL DISABILITY BENEFITS: All employees will receive full salary during the first 90¹ days of total disability, fully offset by any Worker's Compensation, State Cash Sickness² or other federal, state or municipal benefits.

Class A employees will receive full salary for the following 275 days, fully offset by any Worker's Compensation, State Cash Sickness or other federal, state or municipal benefits, as well as benefits provided under long term disability insurance contracts for which the premium is paid for, all or in part, by the employer.

Class B employees³ will receive no benefits from the employer after the first 90 days of salary continuation except that if they elect to participate in the employer sponsored disability insurance plan, they may receive benefits through the insurance company underwriting the contracts. The employer will contribute 25%⁴ of the cost of such insurance as an incentive for the employee to participate.

RESIDUAL DISABILITY BENEFITS: Residual disability benefits are available to Class A employees who qualify and to certain Class B employees who qualify due to income and job. Residual disability concerns the after-effects which cause an individual who returns to his/her job to have a 20% or greater loss in earned income. This income loss may be due to the employee's being unable to perform all of his/her former duties or because the individual is not able to work for as much time as he/she did before the disability.

(Name of Company) or its Qualified Sick Pay Plan will provide no benefits for residual disability to its employees. However, employees who qualify may apply for residual benefits to be added to their disability insurance contracts. Premium charges for this benefit will be paid for by the employee by salary deduction. When premiums for disability income protection are paid by the employee, monthly disability benefits attributable to such contributions will be received on a tax-free basis (I.R.C.104(a)(3)).⁵

AMOUNT OF DISABILITY BENEFITS: The monthly disability insurance benefit you qualify for will be determined by the current issue and participation tables of (name of insurance company), at your time of application.

DEFINITIONS: Definition of total and residual disability and other provisions will be guided by the provisions of the disability insurance contracts underwritten by (name of insurance company).

This is only a sample and is not to be construed as legal advice. It is important to seek the advice of an attorney, as state laws can vary considerably.

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1. Can be 30 days, 60 days or etc., dependent upon need.
 2. Use even in non-cash sickness states to avoid future changes in agreement.
 3. In corporate minutes, identify earning levels for different classes.
 4. Again, dependent on need.
 5. It is imperative that an advisory phrase appear on all sales presentations which states that the client needs to consult his/her attorney or tax advisor as to the tax treatment of disability benefits where the employee pays the premium for that benefit.

SAMPLE:

RESOLUTION OF BOARD OF DIRECTORS.

A special meeting of the board of directors of _____
was held at _____
on the _____ day of _____, 20_____, at _____.

The following directors, constituting a quorum, were present:

The president of the corporation acted as chairman of the meeting, and the secretary of the corporation acted as secretary of the meeting.

The chairman stated that the purpose of the meeting was to consider the adoption of Qualified Sick Pay Plans for certain key employees. After due discussion and upon motion made, seconded and approved, the following resolution was duly adopted:

WHEREAS it is the desire of the corporation to establish Qualified Sick Pay Plans for certain key employees by providing any such employee with an income during total disability and thereby providing any such employee with an added incentive to continue his services to the corporation, and

WHEREAS a method for accomplishing this purpose is provided for under section 105, 106, and 162 of the Internal Revenue Code of 1954 as amended; the Employee Retirement Income Security Act of 1974 as amended; the Tax Reform Act of 1976 as amended; and all rules and regulations pertaining to the aforesaid Codes and Acts, BE IT RESOLVED that Qualified Sick Pay Plans for certain key employees are hereby adopted in accordance with the aforesaid Code, Acts, rules and regulations, subject to the terms of the forms exhibited to the meeting, attached to these minutes, incorporated herein by this reference and made part hereof as if fully set out herein, and covering the following key employees:

BE IT FURTHER RESOLVED that the appropriate officers of the corporation be, and they hereby are, authorized and directed to take such steps as they deem necessary to establish said Qualified Sick Pay Plans and make payments from the funds of the corporation each year as may be required thereunder.

There being no further business before the meeting, the same was, upon motion made, seconded and carried, duly adjourn.

Dated

Signed

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SAMPLE:

LETTER TO KEY PERSON.

(Corporation)

(Name of Employee)

Because of your valuable services to the Company, the Board of Directors has approved a Qualified Sick Pay Plan for you if you become totally disabled due to sickness or injury.

Your Qualified Sick Pay Plan provides that:

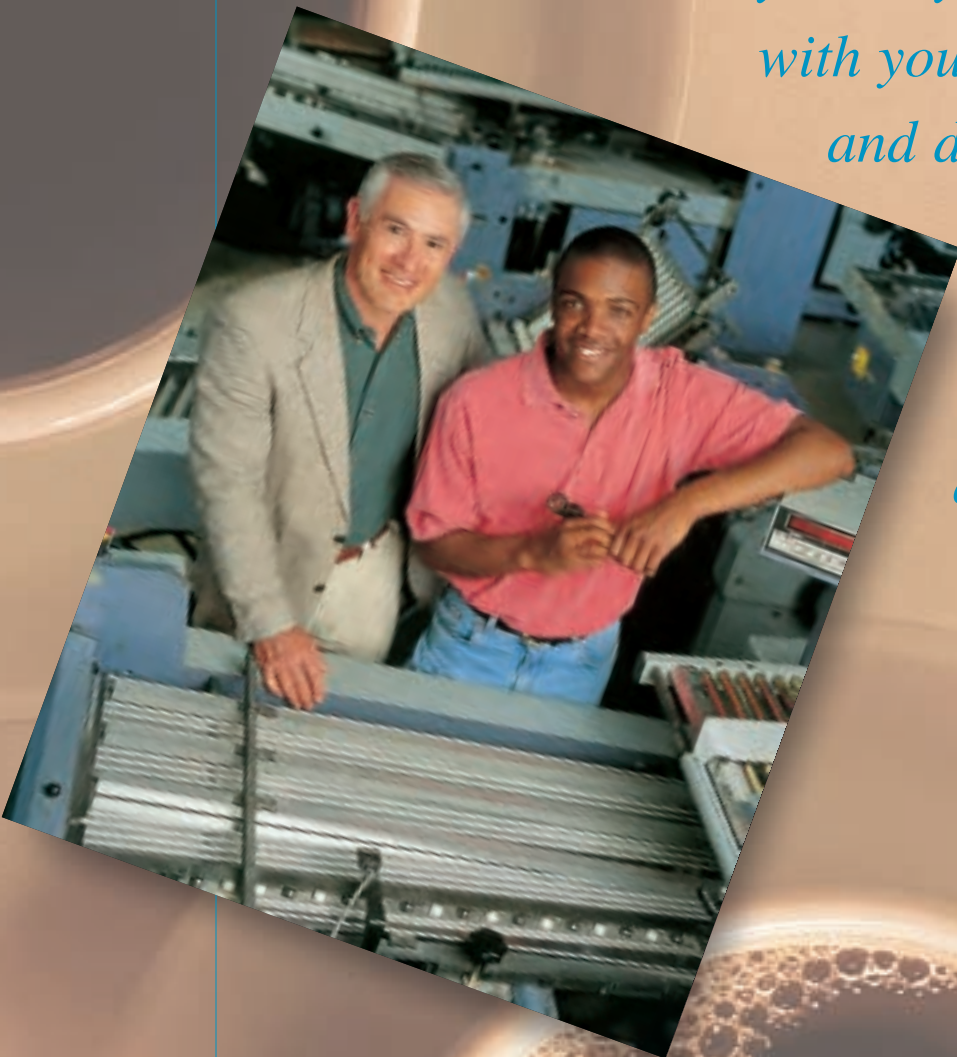
1. During the (insert length of waiting period) of total disability, you will receive your regular wages from this company.
2. If your continuous total disability lasts longer than (insert length of waiting period), you will then receive any and all benefits payable under policy number _____ with the _____ which is enclosed with this letter for your safekeeping.
3. Premiums for the policy will be paid by this company while you are employed by it and while this plan is in effect.
4. This company shall be responsible for and have full discretion with regard to the operation and management of the Plan and any of its assets, except that the insurance company shall have responsibility with regard to those aspects of the Plan which are governed by the terms of the insurance contract. In accepting the foregoing responsibility, this company shall serve as Plan fiduciary and administrator as required by the Employee Retirement Income Security Act of 1974 as amended.
5. If a request for benefits under item 1 is denied, this company will provide you with written notice stating the reasons for denial and an explanation of the procedure by which such denial may be reviewed. Upon request for such review, you or your representative will be permitted to review pertinent Plan documents and submit issues and comments in writing.
6. If a request for benefits under the insurance contract is denied, you or your representative must contact the insurance company for details and review of such denial.
7. This Plan may be amended by a duly authorized vote of the board of directors, which amendment shall be effective immediately.

Sincerely yours,

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WHERE DO YOU GO FROM HERE?

A comprehensive, quality benefits package can help develop high morale and job satisfaction. A Qualified Sick Pay Plan can help you retain the loyalty and services of your key employees. Meet with your financial advisor and discuss the benefits a Qualified Sick Pay Plan can have for you, your employees and your business.



The background of the advertisement features a warm, golden-brown color palette. In the upper left, there is a close-up of a newspaper page with the word "STREET" visible in large, bold letters. The rest of the background is filled with two white ceramic coffee cups filled with dark coffee, topped with a layer of light-colored foam. The cups are positioned on the right and bottom left sides of the page, creating a sense of a quiet morning routine.

ABOUT UNION CENTRAL

The Union Central Life Insurance Company offers its customers financial solutions for a wide range of individual, family and business needs: protection against death or disability, estate planning, tax-advantaged savings, investing,* business continuation and other business planning needs, and group retirement benefits.

Founded in 1867 in Cincinnati, Ohio, Union Central is licensed in all 50 states and the District of Columbia. The company's broad product portfolio includes individual life and disability insurance, annuities, investment products,* and group retirement plans such as 401(k). Union Central has grown and remained strong by adhering to traditional values of quality, integrity and financial soundness.

Union Central is a member of IMSA, the Insurance Marketplace Standards Association. Membership promotes ethical market conduct for individual life insurance and annuities.

UnionCentral
Insurance and Investments

* Securities products are offered through Carillon Investments, Inc., a subsidiary of The Union Central Life Insurance Company, 1876 Waycross Road, Cincinnati, Ohio 45240; (513) 595-2600.

For use with contract UC 4401.

Securities offered through affiliates Ameritas Investment Corp. and Carillon Investments, Inc., members NASD/SIPC. Effective July 1, 2006, securities will be offered through Ameritas Investment Corp.